

Office of Chief Counsel
Internal Revenue Service
memorandum

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date: July 25, 2002

to: LMSB Group 1395 (NR&C)
Attn: Lou Greer, Manager; Lino Galvan, Revenue Agent

from: Area Counsel
(Natural Resources:Houston)

subject: **Corporate Equity Reduction Interest Loss Carryback**

Legend

CERT = Corporate Equity Reduction Transaction
(CERT is used only in the discussion of CERT years)

NOL = Net operating loss

██████████ = ██████████, Inc. & Subsidiaries

Issue

I.R.C. § 172(b)(1)(E) provides that a corporation can carry back its corporate equity reduction interest losses, but not to a year before the corporate equity reduction transaction occurred. ██████████ had a corporate equity reduction transaction in ██████████, and incurred corporate equity reduction interest losses in ██████████ and ██████████. Can ██████████ carry back these losses to ██████████?

Brief answer: Yes.

Facts

In ██████████, ██████████ made a stock acquisition. As a result of this stock acquisition, ██████████ incurred NOLs in ██████████ and ██████████.

The Service agrees that (1) under I.R.C. § 172(h)(3), ██████████'s ██████████ stock acquisition qualifies as a major stock acquisition, and thus qualifies as a corporate equity reduction transaction; (2) certain parts of ██████████'s ██████████ and ██████████ NOLs qualify as corporate equity reduction interest losses defined by I.R.C. § 172(h)(1).

The agent is reluctant to allow ██████████ to carry back the ██████████ and ██████████ corporate equity reduction interest losses to ██████████. His hesitation stems from his position that both ██████████ and ██████████ as well as ██████████ should be considered "CERT years." Thus, under his reasoning, ██████████ cannot carry back the corporate equity reduction interest losses incurred in any of these years.

I. [REDACTED] can carry back its [REDACTED] and [REDACTED] corporate equity reduction interest losses to [REDACTED].

A corporation can carry back its corporate equity reduction interest losses if three requirements are met:

- (1) The corporation must be an **applicable corporation**;
- (2) The corporate equity reduction interest losses occur in a **loss limitation year** ending after August 2, 1989;
- (3) The year to which the corporate equity reduction interest losses are carried back is not prior to the year in which the corporate equity reduction transaction occurred.

See I.R.C. §§ 172(b)(1)(A) and (E).

[REDACTED] meets these requirements:

1. [REDACTED] is an applicable corporation.

An applicable corporation, under I.R.C. § 172(b)(1)(E)(iii), is one that acquires stock or has its stock acquired, in a major stock acquisition. Since it is not disputed that [REDACTED]'s [REDACTED] stock acquisition qualifies as a major stock acquisition, [REDACTED] is an applicable corporation.

2. [REDACTED], [REDACTED] and [REDACTED] are [REDACTED]'s loss limitation years.

A loss limitation year is the taxable year in which the corporate equity reduction transaction occurs and each of the 2 succeeding taxable years. See I.R.C. § 172(b)(1)(E)(ii). Since [REDACTED]'s corporate equity reduction transaction was in [REDACTED], [REDACTED]'s loss limitation years are [REDACTED], [REDACTED] and [REDACTED]. Thus [REDACTED]'s [REDACTED] and [REDACTED] equity reduction interest losses (which the Service does not dispute) occurred in [REDACTED]'s loss limitation years.

3. The losses are carried back to, not before, [REDACTED], the year in which the corporate equity reduction transaction occurred.

Because the requirements of section 172(b)(1)(E) are met, [REDACTED] can carry back its [REDACTED] and [REDACTED] corporate equity reduction losses to [REDACTED].

II. The "CERT year" is not the same as the "loss limitation year."

The term "CERT year" is neither defined nor used in the Code. The Service uses this term to mean the year in which the corporate equity reduction transaction occurs.

The "loss limitation year" is any of the three years in which [REDACTED]'s loss had to have been incurred. In other words, one of the requirements is that [REDACTED] have an equity reduction interest loss in either [REDACTED], [REDACTED] or [REDACTED]. This requirement should not be confused with the requirement that the loss cannot be carried back beyond [REDACTED]. They are separate and distinct rules. Neither section 172(b)(1)(E) nor any other section in the Code suggests that the two succeeding years, here [REDACTED] and [REDACTED], are also considered the year in which the corporate equity reduction transaction occurs (or CERT year as used by the Service).

In conclusion, [REDACTED] can carry back its [REDACTED] and [REDACTED] corporate equity reduction interest losses to [REDACTED]. Please let us know if you have any further questions.

ELIZABETH G. CHIRICH
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(Large and Mid-Size Business)

By: _____
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